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THE MAGAZINE FOR GROWING COMPANIES

JULY 1988
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THE BAD BOYS OF AMERICAN BUSINESS

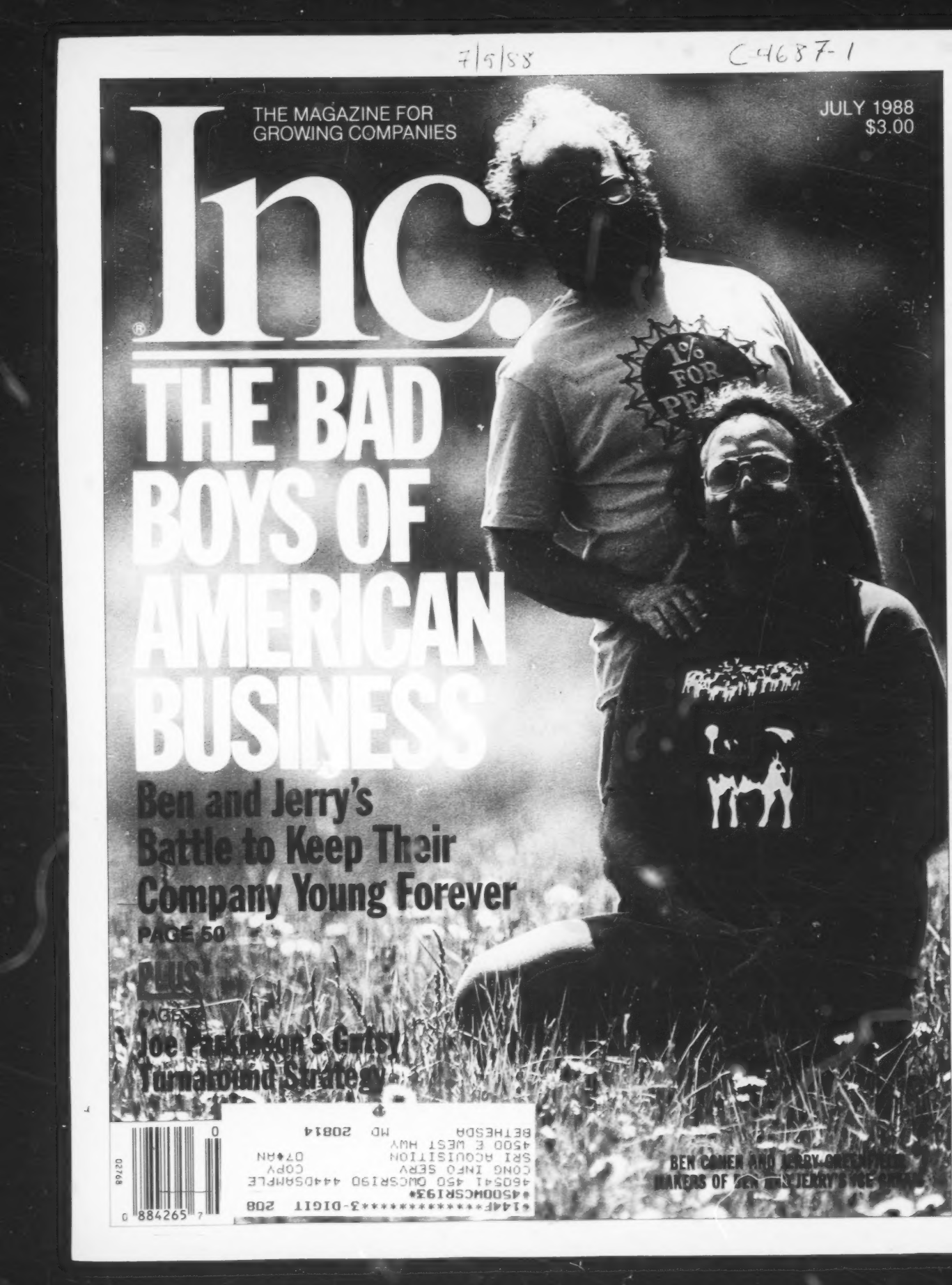
Ben and Jerry's Battle to Keep Their Company Young Forever

PAGE 50

PLUS

PAGE 64

Joe Parkinson's Gritty Turnaround Strategy



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INSIDER

WHO SURVIVES?

The common wisdom has long held that four out of five new businesses fail within five years. Once again, the common wisdom is wrong, at least according to a new study by Bruce Kirchhoff, an entrepreneurship professor at Babson College, and Bruce Phillips, an economist with the Small Business Administration's Office of Advocacy. They report that 39.8% of new businesses survive at least six years. Among growing companies, moreover, the survival rate skyrockets to more than 65%.

Working from an extensive SBA database derived from the Dun's Market Identifier file, Dun & Bradstreet Corp.'s marketing database of 8.5 million companies, the researchers found the lowest survival rate (26%) among start-ups that had less than five employees at birth and then did not grow. If a small start-up added as little as one job, however, its chance of survival more than doubled. In general—and not surprisingly—the survival rate tended to be higher among companies that had created more jobs.

As for the companies that don't make it, Kirchoff is reluctant to call them failures, preferring the word "exits" instead. Failure, he maintains, is an inaccurate and loaded term, since a significant but unknown portion of disappearing small businesses are closed without losses by their owners, who reorganize or move on to other occupations. The distinction matters, according to Kirchhoff, because the stereotype of frequently failing small companies makes policymakers suspect of start-ups as a source of jobs.

START-UPS THAT MAKE IT

A. SIX-YEAR SURVIVAL RATES

Percentage of Companies Surviving After Six Years

Size of Company at Birth	No jobs added	1–4 jobs added	5–9 jobs added	10+ jobs added	Overall
1 to 4 employees	26.0%	65.0%	75.6%	77.5%	37.2%
5 to 499 employees	34.1	72.4	75.3	79.2	49.2
Overall	27.5	66.3	75.5	78.4	39.8

B. GROWTH AND SURVIVAL

Percentage of Companies Surviving After

Employment Growth	Two Years	Four Years	Six Years
No jobs added	70.5%	37.5%	27.5%
1–4 jobs added	92.0	80.9	66.3

The table at the top shows the percentage of companies surviving six years after their founding. As you can see, the lowest survival rate (26%) was among companies that started with one to four employees and did not add any new jobs. The table at the bottom compares the survival rates over time of no-growth and low-growth companies.

Still, if you'd prefer to be among the surviving, rather than the exiting, you'd better hope that growth is in your future. Not that you should rush out and start hiring. Kirchhoff and Phillips don't say whether growth leads to survival, or vice versa. Maybe that will be the next study. —*M.E.M.*

DIVINE INTERVENTION

We know many companies that have tried to gain an edge by seeking out psychics, handwriting experts, and management gurus. But a few companies are turning to a higher authority: God. They are hiring former priests and ministers and—in so doing—getting managers whose people skills are, well, heavenly. As for the ex-preachers, they say their religious training is often exactly what's needed.

Paul Pieschel, now vice-president of franchise development for Dayton-based Moto Photo Inc., is typical. "When franchisees get into trouble, you can often trace it to a personal problem," says the former priest. "The marriage isn't going well, or there's an alcohol problem, or whatever. Given what it takes to train a franchisee, it makes a lot more sense to try to solve the problem than to terminate the relationship."

Garry Ritzky, personnel and risk manager for Turner Bros. Trucking Co., in Oklahoma City, agrees that his clerical background has helped. He is often the one who appears in court when Turner Bros. is involved in litigation. He says lawyers tend to go easier on former United Methodist ministers. "They're a little less eager to tear me limb from limb." —*Paul B. Brown*

CAT POWER

We've told you about the youth market, the senior market, and ethnic markets. But there's one market we seem to have overlooked—felines. That didn't stop some overly zealous employees of Seaview Subaru, in Westbrook, Conn.: according to a complaint filed by the state attorney general's office, Seaview "sold" Subaru cars to any number of made-up customers, including Sidney Chatpuma and Maxwell Puma, who happened to be one employee's cats.

The alleged purpose? To allow the dealership to file false claims for warranty work on the unsold cars with the auto manufacturer. (The cars were later sold to real customers.) That, at any rate, is what the Connecticut state police charge. Then again, maybe the cats were just good customers. . . . —*M.E.M.*

ILLUSTRATION: MIKE REED

WHAT GOES UP...

Volatility creates ulcers for entrepreneurs and headaches for people who deal with them, but it's what keeps our economy strong

BY DAVID L. BIRCH

Most U.S. companies can be counted into one of only two camps. One is income oriented, the other entrepreneurial. The former camp houses all those enterprises created primarily to provide an alternative to working for someone else. These income businesses reach a steady employment level early in their history and, mostly, stay there. They are the local drugstores, flower shops, or garages. Their volatility—their tendency to grow or decline—is very low, usually zero.

Not so the occupants of camp number two. If one learns anything by following the individual fates of 12 million establishments over 18 years, it's that entrepreneurial businesses—growth companies—never just grow and rarely just decline. They do both, sequentially. As you might know if you run such a company, they seem strapped to a roller coaster, and they can't get off.

Cases differ, of course, but the patterns don't. Entrepreneurial businesses stumble onto something, get a big boost out of it, and grow significantly. Then, as soon as they think they're rounding third base, someone always seems to move home plate. Maybe there's a change in their economic world. Other competitors close in on them. A new technology eliminates the value of their market niches. Or perhaps they simply get cocky, or lazy, and lose track of the direction in which they were headed.

Whatever the cause, the inescapable fact is that the most likely result of any company's rapid growth is a slowdown—even outright decline is quite common. But entrepreneurs are not stupid; in most instances, they learn from their mistakes or misfortunes. They reduce staff, develop new products, shackle costs, or crank up their marketing and selling machinery. More often than not, their companies take off again.

This chart makes the phenomenon plain: the best predictor of a big company's decline is previous rapid growth, the best predictor of rapid growth is a previous big decline, and stability is tied to a big decline as the best predictor of death. The company that tries to step off the ride and stand still is much more likely to go out of business than the company that hangs on through the ups and downs. And curiously enough, the phenomenon appears to be independent of company age, size, or industry.

Such volatility—and the democratic way it afflicts all manner of entrepreneurial business—prompts a question: *why?* Don't these companies ever learn from the past?

But the question is probably unfair. All the numbers assert that growth is inherently volatile. It is filled with uncertainties and unknowns that require companies to make constant adjustments—movements both forward and backward—simply to stay alive.

Still, if you're running an entrepreneurial business, there are lessons in this. By understanding volatility, you perhaps can make the terrain between peaks and valleys less steep.

You might think a little bit more about the business environment around you—try to anticipate what might clobber you next, and get ready for it. There's a tendency during periods of growth to begin thinking that success has resulted from your actions alone, independent of events in the outside world. Yet usually there is a good chance that the niche you've found, and are thriving in, was created as a result of some broader force—a baby boom, a strong dollar, rising oil prices, a generally vigorous economy, low interest rates, a strong stock market, or an aging population.

But things change, often when you're certain they won't. Nobody in Houston thought Houston would stop growing. No one thought the stock market would crash. Very few people realize that the baby boomers have stopped entering the work force (they're all in it now), and few have anticipated the consequences for office construction, the auto industry, or the appliance market.

So you should think carefully about what your success, or failure, is attributable to, what will happen if those circumstances change, and how you can prepare for (and better still, capitalize on) that change.

You might also plan better—look ahead more prudently and in greater detail at your cash flow; cut expenses before you run out of money. Realistically (and certainly statistically), most of you will not do these things until it is too late, and you will ride the roller coaster along with everyone else.

But if you think *running* these companies is tough, try selling to them. Their needs, like their fortunes, are highly volatile. One minute they want to double their office space, the next they are walking away from their leases. On the up cycle, they are buying or leasing equipment like crazy, only to find themselves with excess capacity (and a short time later, no ability to pay for it). As they grow, they need money; as they decline they struggle mightily just to meet their fixed financial obligations.

Yet you cannot afford to ignore these companies as a market because, on the average, they constitute most of the net growth in the economy. So you will have to learn how to tailor your product or service to be inherently suited to volatility. Perhaps you can offer lease options as well as a straight purchase. Maybe you can create flexible plans through which you repossess what the growing companies don't

PATTERNS OF EMPLOYMENT GROWTH AND DECLINE, 1983–87

Companies Grouped by Their 1983–85 Performance	And How They Fared, 1985–87					
	Rapid growth	Slow growth	No change	Small decline	Big decline	Close
Rapid growth	8.8	11.6	53.9	11.4	6.1	8.2
No change	4.9	3.9	72.9	4.5	1.9	11.9
Big decline	15.3	3.2	63.8	3.2	2.4	12.0

Volatility occurs independent of company age, size, or industry.
By understanding volatility, you can prepare strategies for dealing with it.

need when they don't need it, and provide an ample supply of it when they do.

Because it's likely you extend credit to volatile companies, you're already in the business of financing the downturns whether you have recognized it or not, so you might turn that into an advantage by making cyclical financing a part of your original offer. Whatever you do, if you can't do it so that a volatile company can use it, pretty soon someone else will be serving most of the growth in America.

From a broader perspective, politicians and economic developers view this process with horror. They see the newspaper accounts of layoffs and plant closings all the time, and must deal with each one as a potentially embarrassing statement about the failure of their administrations or programs. It makes them look bad, and, by and large, bad is exactly how they'd describe the phenomenon as a whole. The Europeans, it's interesting to note, are so concerned about volatility that they have in many ways outlawed it.

Yet the fact remains: volatility is healthy. It cleans out bad ideas, out-of-date products, and inefficient people, replacing them with new ideas, products, and services. You can't glue the leaves on the trees—as the Europeans have tried so hard to do. You have to recognize failure for what it is and let it drain out of the economic system.

If you don't allow failure an escape route, you will simply accumulate it in your existing institutions—with disastrous consequences. Over the past 15 years, in the face of a baby boom of its own, Europe has increased its job base by only 1.1%—*one-thirtieth* of the comparable growth in the United States.

As a nation we cannot, and should not, want to stop failure from happening. The rates of job losses due to volatility vary little from place to place. No area has figured out how to retain jobs. In fact, the healthiest economies in the country have the *highest* company-closing rates and overall job-loss rates, all because of volatility.

We must, however, do a far better job of dealing with volatility's consequences. Our Achilles' heel is the dislocated worker—approximately 20 million people leave their jobs every year. As their skills become obsolete and their ability to land on their feet decreases each time they move, our ability to maintain a healthy economy decreases. Our challenge is thus not to minimize failure, but to turn it into an opportunity for those it affects. □

David L. Birch is president of Cognetics Inc., in Cambridge, Mass., and director of MIT's Program on Neighborhood and Regional Change.

What did you do to deserve Beefeater?

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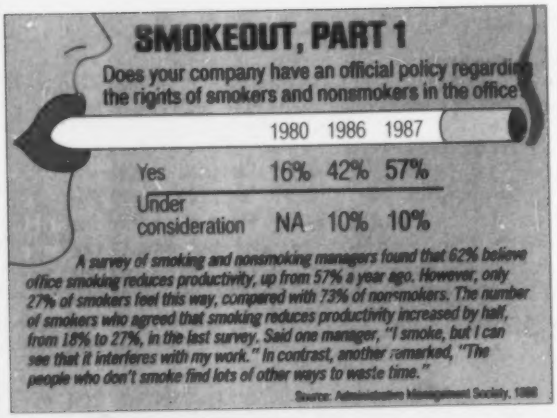
The best of times deserve the best of taste.

94 Proof. 100% grain neutral spirits. The Buckingham Wile Company, N.Y. © 1988.

HANDS ON

A Manager's Notebook


SMOKEOUT, PART 1
Does your company have an official policy regarding the rights of smokers and nonsmokers in the office?
1980 1986 1987
Yes 16% 42% 57%
Under consideration NA 10% 10%
A survey of smoking and nonsmoking managers found that 62% believe office smoking reduces productivity, up from 57% a year ago. However, only 27% of smokers feel this way, compared with 73% of nonsmokers. The number of smokers who agreed that smoking reduces productivity increased by half, from 18% to 27%, in the last survey. Said one manager, "I smoke, but I can see that it interferes with my work." In contrast, another remarked, "The people who don't smoke find lots of other ways to waste time."
Source: Administrative Management Society, 1988

RECRUITING

HELP AND HOW TO FIND IT

Tired of placing help-wanted ads for secretaries and clerical help only to get a few or no responses? Tired, too, of conceding whatever salary your candidate asks, even if it is more than you budgeted?

Paul Olsen, of Harvard Consulting Group, has this advice: stop running four-line ads in a major paper, where they get swallowed by all the ads surrounding them, and place a large display ad in a few local papers instead. It might cost a little more, but will undoubtedly get more responses.

For Olsen, the tactic has worked even in the extremely tight Boston labor market—partly, he thinks, because he's used the extra ad space to tout "family atmosphere" or "flexible hours." Someone who values a position's intangibles may be more willing to accept a modest salary. □

SALES

FRESHENING UP

Have you ever seen a sales force view commissions more as Social Security checks than as a reason to drum up new business? Rick Johnson has. So when he founded BurJon Steel Service Center Inc., in Springboro, Ohio, he made some changes.

Tired of seeing some salespeople live off old accounts, he decided to eliminate commissions on accounts once they have been with BurJon for one year. The client becomes a house account, still serviced by the original rep, but money goes into companywide profit sharing instead of into commissions.

Johnson reads weekly call reports to ensure that house accounts remain well cared for. Though commissions cease, reps who do good work with old clients can receive year-end bonuses—of as much as $10,000—and salary adjustments.

The big money, though, is in new customers, Johnson says. "There is unlimited commission potential here, but you've got to write new business to exploit it."

Overall, the system seems to have worked. The company's revenues have risen from $1 million in 1980 to $20 million in 1987. □

MARKETING

UNNATURAL SELECTION

Sometimes the best way to grow your business may be to turn business away. At University National Bank & Trust Co., in Palo Alto, Calif., only checking-account customers may apply for loans, open savings accounts, or buy certificates of deposit. The aim? To build stronger customer alliances with the full range of the bank's services.

"The place where you have your checking account is the place where the relationship is," says Carl J. Schmitt, University National's founder and chairman. "They're the people you think of as your bankers."

The policy has meant turning away $25 million to $30 million in CD business in the past eight years, but Schmitt claims the trade-off has been worth it.

Indeed, customers have responded to the "relationship"—sweetened by such perks as postage stamps at no extra cost and free shoe shines—by putting more and more money into "their" bank. The institution's deposit base grew 40% last year. □

PROMOTION

THE FREQUENT-BUYER DISCOUNT

Chances are, your company could benefit from increased customer loyalty just as much as the airlines can. So why not borrow their most effective gimmick? That's what Terry Finn did when he adapted the frequent-flyer idea to One Hour Delivery Service Inc., the courier business he runs in Dallas.

Like the plans it mimics, Finn's frequent-caller program targets the actual users of his service. The secretaries, mail clerks, and receptionists who decide which courier will be summoned are the program's beneficiaries.

Customers accrue one point per delivery, except for downtown deliveries, which are only a tenth of a point. Monthly statements of point balances are accompanied by a four-color flier promoting such popular prizes as chocolates (30 points) and a dozen roses (15 points). "We're putting a lot into this program," says Finn, whose clientele has stampeded to sign up, "but customer loyalty is worth it." □

TRAINING

TOGETHER NOW

One of the best ways to make job training bearable is to make it fun. What's more, a training period that's enjoyable can foster camaraderie and introduce newcomers to a corporate culture. Ask Joe Crugnale, who claims to accomplish all of the above every time he opens a Bertucci's restaurant.

Since 1985, CEO Crugnale's company, based in Woburn, Mass., has opened eight eateries, with five more coming soon. For the first two weeks of each launch, he and his top seven corporate managers work side by side with the waiters, bartenders, and dishwashers. After the weeks of tedious paperwork and negotiations, Crugnale claims, the prospect of manual labor is actually appealing. "We kid around a lot with the new hires, and it breaks up the monotony of the legal stuff for the managers. It's the fun part of opening a restaurant."

Managers of the new restaurants love the arrangement. "We know they need help, so we just fill in wherever we can for 15 hours a day," Crugnale says. Then there's the message it sends to employees: "The new hires see us go, go, go, and they work a little harder." □

CHARTS: CYNTHIA DAVIS

HANDS ON

LAW

A NONCOMPETE WITH TEETH

The trouble with most noncompete agreements is that they haven't a prayer of holding up in court. They're usually too vague and too restrictive, aiming to provide far more protection than most companies actually need—and far more than most judges will permit. So says Harvey Mackay, chairman and CEO of Mackay Envelope Corp., in Minneapolis.

Mackay's standard agreement has been a success for 25 years—solid in the courtroom and, more important, both effective and fair outside it. Former employees may go to work for another envelope company immediately—with only two restrictions, both of which hold for two years.

Mackay restricts former employees from selling envelopes in only a small area, such as the cities where most of their old accounts were.

Then there's what may be the contract's strongest component: the client list, rendered off-limits after a salesperson leaves Mackay Envelope. "These are valuable accounts," Mackay says. "We want to make it clear that they're Mackay Envelope's property." □

'What he said changed my strategy on the spot. So I paid for dinner, and he's been paying ever since.'

—Bruce McKinney, of Consolidated Dutchwest Inc. (#144 on the 1987 INC. *500), on a competitor who bragged how well mail order was working*

PARTNERS

IN WRITING

You may be hesitant to discuss the potential breakup of your business partnership, fearing that such talk could prove self-fulfilling. But clarifying sticky questions while your partners are on good terms can help prevent some of the tension that leads to business divorce. And if you *do* decide to split, written agreements can assure that everyone's treated fairly.

"There's an assumption by many partners that even if their businesses fail, they'll be partners forever," says attorney David Gibbs, of Boston's Peabody & Brown. He advises clients to set up an agreement detailing how they'd establish the worth of company stock if one partner wanted out, what each would do if a partner should die, and how to govern the sale of stock to outsiders. For small companies, most such agreements cost between $1,000 and $4,000.

And there's a side benefit, says Gibbs. Partners who can't come to terms on how they'd get out of their relationship might want to rethink getting into one. □

SMOKEOUT, PART 2

In what areas of the building does your company now ban smoking?

Hallways	32%
Meeting rooms	31
Public areas/reception	30
Storage	28
Open offices	26
Security areas	16
Cafeteria	15
All areas	14
No ban	5

Source: Administrative Management Society, 1988

STRATEGY

ON YOUR OWN

It's impossible to know too much about a company you're on the verge of acquiring, but lots of CEOs miss a chance to discover more: final negotiations. With all the stress that accumulates, it's a good time to examine the staff you're about to take on. How do they handle pressure? Are they hiding anything?

If you want to find out, Lawrence M. Powers says, push aside the lawyers and handle the final negotiations yourself.

Powers is chairman and CEO of Spartech Corp., a Clayton, Mo., plastics manufacturer he has built into a $210-million company with a string of acquisitions—the negotiations for which, he says, have been "very instructive." When the smiling facade across the table breaks down, you learn how people handle conflict. Equally important, you'll be alerted to potential problems within the company if its managers won't yield anything in negotiations. □

INTERNATIONAL MARKETING

HANDS ACROSS THE WATERS

What with the constant influx of foreign competition, and the falling dollar, you'd love to beef up your company's presence overseas. But the idea of setting up foreign distribution, hiring a new sales force, and trying to keep an eye on performance "over there" scares you to death. What to do?

Think like Michael Lepiner. The president of Los Angeles–based Telecom Entertainment Inc. has come up with a way to make international business less daunting: find a foreign friend, and have him buy in.

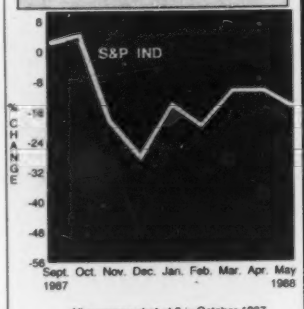
Telecom makes television movies—such as *The Attic: The Hiding of Anne Frank*, which appeared on CBS in April—but Lepiner's approach could work for almost anyone. When developing a movie script with international appeal, Lepiner searches for overseas broadcasters and offers them a piece of the action. In return, he gets more than money—he gains knowledgeable foreign contacts and help with distribution, production, and advertising. There is no need for brokers or other middlemen.

Although in most cases the arrangement works like a joint venture, Telecom often retains the final say, which can be part of the deal's appeal. Also appealing is the potential for reciprocity. Says Lepiner: "When your foreign partners are looking to do business here, they're likely to come to you." □

Reported by Sara Baer-Sinnott, Leslie Brokaw, Paul B. Brown, Teri Lammers, and Amy Schulman

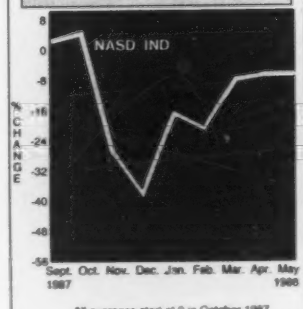
INVESTING IN GROWTH COMPANIES

INC. vs. CONSERVATIVE AVERAGES



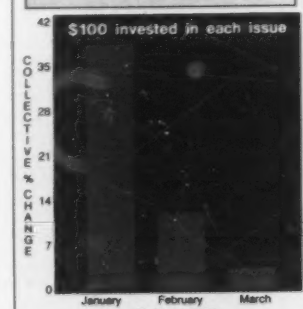
All averages start at 0 in October 1987.

INC. vs. SPECULATIVE AVERAGES



All averages start at 0 in October 1987.

IPOs IN THE AFTERMARKET



INITIAL PUBLIC OFFERINGS: APRIL 1988

O-T-C sym.	Company	Business/product	Offering Size ($mil.)	Offering Price	First aftermarket bid	Underwriter
AC[a]	Alliance Capital Management L.P.	Investment adviser	65.00	10.00	10	Donaldson Lufkin
ACD[a]	American Capital Income Trust	Closed-end fund	130.00	10.00	10	Smith Barney
AGF[a]	American Government Income	Closed-end investment fund	132.00	8.00	8	Piper Jaffray
ICE[b]	Arctic Alaska Fisheries	Operates fishing fleet	47.19	13.00	13¼	Merrill Lynch
BZF[a]	Brazil Fund	Closed-end fund	150.00	12.50	14¼	First Boston
CEFR	Cease Fire	Mfrs. & mkts. fire extinguishers	5.00	5.00	5¼	Whale Securities
CNNR	Conner Peripherals	Designs & mkts. disk drives	32.00	8.00[c]	8	Shearson Lehman
CCXLA	Contel Cellular	Provides cellular-telephone svcs.	85.00	17.00	17	Drexel Burnham
CLFI	Country Lake Foods	Mfrs. & mkts. dairy prods.	13.00	10.00	10	Piper Jaffray
DON[b]	Donnelly	Mfrs. automobile mirrors & glass	13.80	11.50	13⅛	Roney & Co.
FSCXU	Fastcomm Communications	Mfrs. & mkts. data-comm. prods.	2.00	5.00[d]	5	Alison, Baer
FVF[a]	Finevest Foods	Distr. wholesale frozen foods	40.80	12.50[e]	12½	Merrill Lynch
FBI[a]	First Boston Strategic Income	Closed-end fund	87.00	12.00	12⅛	First Boston
IBF[b]	First Iberian Fund	Closed-end investment fund	27.50	10.00[f]	10	Prudential-Bache
HYP[a]	High Yield Plus Fund	Closed-end investment fund	105.50	10.00	10	Prudential-Bache
HUGEU	Humagen	R&D of male infertility	3.38	5.00[f]	5¼	Rosenkrantz Lyon
IMTKU	Information Management Technology	Provides informational mgmt. svcs.	4.00	5.00[h]	6½	D. H. Blair
KHI[a]	Kemper High Income	Closed-end fund	204.00	12.00	12	Paine Webber
OS[b]	Oregon Steel Mills	Owns & operates steel minimill	61.50	20.50	22½	Merrill Lynch
PIM[a]	Putnam Master Intermediate	Closed-end investment fund	360.00	10.00	10	Shearson Lehman
SKNU[b]	Skoiniks	Owns & operates restaurant chain	4.00	5.00	4½	Paulson Investments
SEGIU	Sports/ Entertainment Group	Sports entertainment svc.	6.00	3.00[g]	3	First Interregional
STFD	Standard Federal S&L	Savings & loan bank	4.82	5.00	5	Keefe Bruyette
USWNA	U.S. WEST NewVector Group	Operates cellular-phone systs.	134.00	20.00	20½	Salomon Bros.
ZIF[a]	Zenith Income Fund	Closed-end fund	85.00	10.00	10	Shearson Lehman

[a] trading on NYSE; [b] trading on AMEX; [c] an additional 1 million shares were offered overseas; [d] units of 4 common + 1 warrant; [e] an additional 816,000 shares were offered overseas; [f] an additional 3.75 million shares were offered overseas; [g] units of 1 common + 1 warrant; [h] units of 3 common + 3 warrants. Offering data source: *GOING PUBLIC: THE IPO Reporter*, a publication of The Dealer's Digest Inc., 150 Broadway, New York, NY 10038.

CHARTS: IMAGEBUILDER DESIGN

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